APPENDIX

APPENDIX

Internal Revenue Code (26 U.S.C., 1946 Edition)

Sec. 113. Adjusted Basis for Determining Gain or Loss.

(a) *Basis (Unadjusted) of Property.* The basis of property shall be the cost of such property; except that . . .

(7) *Transfers to Corporation.* If the property was acquired

(A) after December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, or

(B) in a taxable year beginning after December 31, 1935, by a corporation in connection with a reorganization,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

(8) *Property Acquired by Issuance of Stock or as Paid-in Surplus.* If the property was acquired after December 31, 1920, by a corporation

(A) By the issuance of its stock or securities in connection with a transaction described in section 112(b)(5) (including, also, cases where part of the consideration for the transfer of such property, to the corporation, was property or money, in addition to such stock or securities, or

(B) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

Sec. 718 (as added by § 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974). EQUITY INVESTED CAPITAL.

(a) *Definition.* The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b) . . .

(2) *Property Paid-in.* Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. . .

Revenue Act of 1928. (c. 852, 45 Stat. 791)

Sec. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.* Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111 shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind* . . .

(4) *Same—Gain of Corporation.* No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) *Transfer to Corporation Controlled by Transferor.* No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in

exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange . . .

(i) *Definition of reorganization.* As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of reorganization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) *Definition of control.* As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

Stock Corporation Law of New York

Sec. 22. *New Corporation may be formed under the same name.* Whenever pursuant to section twenty any domestic

stock corporation, except a railroad or moneyed corporation shall desire to sell and convey its property, rights, privileges and franchises, or any interest therein or any part thereof to a new domestic corporation, the latter may be organized under the same name, provided that:

1. There shall have been included in the stockholder's consent express consent that good will and right to use the corporate name be sold, that a new domestic corporation be organized with the same name to acquire the property, rights, privileges and franchises, or any interest therein or any part thereof, and the good will and name of such existing corporation, and that such existing corporation be dissolved upon the expiration of the period of fifteen days from the filing of the certificate of incorporation of such new corporation in the proper state office.

2. There shall be annexed to the certificate of incorporation of the new corporation, an affidavit by the president or a vice-president and the secretary or an assistant secretary of the existing corporation stating that the consent of the stockholders required by the foregoing subdivision of this section has been duly given.

3. There shall be included in the certificate of incorporation of the new corporation a statement that it is organized to acquire the property, rights, privileges and franchises, or an interest therein or a part thereof, and the good will and name of an existing domestic corporation and a statement of the date of filing of the certificate of incorporation of such existing corporation, the state office where filed, or the special law under which it is organized.

4. The consent of the department of taxation and finance to the filing of such certificate shall be indorsed thereon.

Upon the expiration of the period of fifteen days from the filing of the certificate of incorporation of the new corporation in the proper state office the corporate existence of the old corporation shall cease and it shall be deemed dissolved. Its directors shall proceed to settle its affairs

pursuant to the provisions of section thirty-five of the general corporation law and of subdivisions eight and nine of section one hundred and five and of section one hundred and six of this chapter.

Sec. 29. *Directors as trustees in case of dissolution.* Upon the dissolution of any corporation, its directors, unless other persons shall be designated by law, or by a court of competent jurisdiction, shall be the trustees for its creditors, stockholders or members and shall have full power to settle its affairs, collect and pay its outstanding debts, and distribute to the persons entitled thereto the assets remaining after payment of debts and necessary expenses.

The provisions of sections twenty-seven and twenty-eight shall apply to the meetings and acts of the trustees.

Such trustees shall have power in the corporate name by one or more of their number thereunto designated to transfer and convey its property, and may sue and be sued in such name. They shall jointly and severally be accountable to its creditors, stockholders or members, for the property which shall come into their possession.

Sec. 69. *Consideration for issue of stock and bonds.* No corporation shall issue either shares of stock or bonds, except for money, labor done or property actually received for the use and lawful purposes of such corporation. No shares of stock having par value shall be issued for money in an amount less than the par value of such shares. Any corporation may purchase any property authorized by its certificate of incorporation, or necessary for the use and lawful purposes of such corporation, and may issue stock to the amount of the value thereof in payment therefor, and the stock so issued shall be full paid stock and not liable to any further call, neither shall the holder thereof be liable for any further payment under any of the provisions of this chapter; and in the absence of fraud in the transaction the judgment of the directors as to the value of the property purchased shall be conclusive; and in all statements and reports of the corporation by law required to be pub-

lished or filed, this stock shall not be stated or reported as being issued for cash paid to the corporation, but shall be reported as issued for property purchased.

Opinion of United States Court of Appeals For the Second Circuit

---

Decided December 6, 1954

FRANK, Circuit Judge:

The pertinent statutory provisions are set forth in the footnote.[1]

---

[1] "26 U.S.C., 1946 ed. Sec. 113: ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

"(a) *Basis (Unadjusted) of Property.* The basis of property shall be the cost of such property; except that . . .

"(6) *Tax-free Exchanges Generally.* If the property was acquired, after February 28, 1913, upon an exchange described in section 112(b) to (e), inclusive, the basis (except as provided in paragraphs (15), (17), or (18) of this subsection) shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss of the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. . . .

"(7) *Transfer to Corporation.* If the property was acquired

"(A) after December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, or

"(B) in a taxable year beginning after December 31, 1935, by a corporation in connection with a reorganization,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer

The facts are stated in the opinion and findings of the Tax Court, reported in 18 T.C. 1255. In part they read as follows:

"The stockholders of the old corporation, at a special meeting, expressed their desire to dissolve the

---

was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transferor.

"(8) *Property Acquired by Issuance of Stock or as Paid-in Surplus.* If the property was acquired after December 31, 1920, by a corporation

"(A) By the issuance of its stock or securities in connection with a transaction described in section 112(b)(5) (including, also, cases where part of the consideration for the transfer of such property, to the corporation, was property or money, in addition to such stock or securities, or

"(B) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. . . .

"Sec. 718 (as added by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974). EQUITY INVESTED CAPITAL.

"(a) *Definition.* The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b) . . . .

"(2) *Property Paid-in.* Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. . . .

"Revenue Act of 1928, c. 852, 45 Stat. 791:

"Sec. 112. RECOGNITION OF GAIN OR LOSS.

"(a) *General rule.* Upon the sale or exchange of property the entire amount of the gain or loss, determined under section

old corporation and to sell the assets and distribute the proceeds. They passed resolutions on March 12, 1930, consenting to the formation of a new company

111 shall be recognized, except as hereinafter provided in this section.

"(b) *Exchanges solely in kind.* . . .

"(4) *Same—Gain of Corporation.* No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan or reorganization, solely for stock or securities in another corporation a party to the reorganization.

"(5) *Transfer to Corporation Controlled by Transferror.* No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities recieved by each is substantially in proportion to his interest in the property prior to the exchange. . . .

"(i) *Definition of reorganization.* As used in this section and sections 113 and 115—

"(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferr or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of reorganization, however effected.

"(2) The term 'a party to a reorganization' includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the the total number of shares of all the other classes of stock of another corporation.

"(j) *Definition of control.* As used in this section the term 'control' means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation."

of the same name and the dissolution of the old company, 15 days thereafter, as provided by Section 22 of the Stock Corporation Law of New York. It was also resolved to have the directors sell the assets, good will and corporate name of the old company to the new corporation. Preferred stock of the new corporation was to be received for the value of the physical assets and net worth, and common stock of the new corporation aggregating a par value of $750,000 was to be taken in payment for all other property including good will and the right to use the corporate name. The new corporation, Bard-Parker Company, Inc. (hereinafter referred to as the petitioner), was incorporated in New York on April 8, 1930. The old company was automatically dissolved on April 24, 1930. The authorized capital stock of the new corporation was $1,950,000, consisting of 4,500 shares of $100 par value 7 per cent cumulative preferred and 150,000 shares of $10 par value common stock. The petitioner, through its directors, purchased the tangible assets of the old company from the liquidating directors of that corporation on April 28, 1930, for $209,300 par value preferred stock and the assumption of liabilities of $18,855.59. The intangible assets of the old company were purchased for $750,000 par value common stock of the petitioner. The memorandum of agreement states that the old company had been dissolved.

"The liquidating directors of the old company listed the shareholders of that corporation and the number of preferred and common shares to be issued to each in payment of the tangible and intangible assets of the old company. The preferred shareholders of the old company received $50,000 par value in preferred shares of the petitioner. The remaining $159,300 of the purchase price of the tangible assets was paid to the common stockholders of the old company in the ratio in which they owned stock of their corporation. . . . The common stock of the new corporation was issued in the same ratio. . . .

"On the same date the directors of the petitioners authorized the purchase of certain patents and applications, accepting an offer made by Harry B. Arden. These patents and applications purchased by the peti-

tioner for $750,000 through Arden were owned by Morgan Parker. . . .

"Gain or loss was not reported by petitioner or Morgan Parker from the transactions involving the purchase by petitioner of the old company's assets and Morgan Parker's patents.

"J.W.B. Ladd received $50,000 par value in common stock of the petitioner for his services. . . ."

In its excess profits tax returns for the taxable years taxpayer included in its equity invested capital, for the purpose of computing its excess profits tax credit, the full par value of its common stock in the amount of $1,550,000. The Commissioner in his notice of deficiency reduced the invested capital by that amount. The Tax Court sustained the Commissioner's determination in part. With respect to the $50,000 of stock issued for Ladd's services, the Tax Court held that no amount was includible in equity invested in capital. With respect to the $750,000 of stock issued for the old corporation's intangible assets, it held that the amount includible was the cost to the old corporation. With respect to the $750,000 of stock issued for Parker's scissors patents, it held that the amount includible was cost to taxpayer, i.e., the fair market value of the patents at the time they were acquired, which it found ot be $300,000.

Taxpayer appeals from so much of the Tax Court's decisions as is adverse to it. The Commissioner has not cross-appealed.

1. The first question has to do with the intangible assets of the old company, acquired in 1930 in exchange for $750,000 par value of the new company's common stock. The Tax Court held that this was a tax-free acquistion "in connection with a reorganization" under Section 112(b)(4) of the 1928 Act; that therefore the "basis" of those assets, under 28 U.S.C. 1946 ed. Section 113(a)(7), is the same as it would be in the hands of the old company;

and that consequently this "basis" represents the new company's "equity invested capital," relative to those intangible assets, pursuant to 28 U.S.C. 1946 ed. Section 718(a)(2).

Taxpayer contends that the transfer of these assets was not tax-free under Section 112(b)(4) or Section 112(b)(5) of the 1928 Act; that therefore the "basis" of those assets is their market value in 1930 when the new company acquired them in exchange for some of its common stock; and that, accordingly, that value must be used in computing the new company's "equity invested capital" under Section 718(a)(2). In support of this contention, taxpayer advances several arguments:

(A) Section 112(b)(4), by its terms, relates solely to a "reorganization" in which a "corporation" exchanges property for securities in another "corporation." But here, says taxpayer, the parties to the exchange of these assets were (1) some "natural persons," as transferors, and (2) the new corporation as transferee; for, in accordance with the New York statute, the old company was dissolved, title to its assets then vested in its former directors as "liquidating trustees," and those persons transferred the assets of the dissolved old company to the new company.

We cannot agree. We think the Tax Court correctly held that the lequidating directors served merely as a "conduit" through which title passed to the new corporation. The obvious aim of Section 112(b)(4) may not so easily be balked. In *Helvering* v. *Limestone Company,* 315 U.S. 179, 184-185, the Court said that "the separate steps were integrated parts of a single scheme. Transitory phases of an arrangement frequently are disregarded under the sections of the revenue acts where they add nothing of substance to the completed affair. . . . Here there were no more than intermediate procedural devices to enable the new corporation to acquire all the assets of

the old one pursuant to a single reorganization plan."[2] See also *Survuant* v. *Commissioner,* 162 F. (2d) 653 (C.A. 8); *cf. Gregory* v. *Helvering,* 69 F. (2d) 809 (C.A. 2), aff'd. 293 U.S. 465; *Kocin* v. *United States,* 187 F. (2d) 707 (C.A. 2).

We conclude, then, that, in applying Section 112(b)(4), this transaction may not be treated as two transfers—one from the old company to its directors and a second from those directors to the new company—since those two transfers were but procedural steps used to complete what, in substance, constituted a single transfer.[3]

(B) Taxpayer also argues, as follows: Here there were two concurrent transfers in exchange for the stock of a corporation, i.e. the transfer from the old company and the transfer of the patents; in such circumstances, says the taxpayer, "the transaction must meet the tests of Section 112(b)(5) to be non-taxable," and, if it does not, then Section 112(b)(4) must be disregarded, because those subsections are mutually exclusive; and here (so the Tax Court found) Section 112(b)(5) did not fit the transaction, since the interests of the transferors in the stock of the new company was disproportionate to their interests in "the property prior to the exchange."

We think that contention untenable. Section 112(b)(4) and (5) are cumulative, not mutually exclusive. See *Helvering* v. *Cement Investors,* 316 U.S. 527, 533-534; *Britt* v. *Commissioner,* 114 F. (2d) 10 (C.A. 4); *Barker* v. *United States,* 200 F. (2d) 223, 229 (C.A. 6); *Nelson* v. *United States,* 69 F. Supp. 336.

Taxpayer cites cases in which, according to taxpayer, the courts having held that a transaction was not tax-free because it did not meet the tests of Section 112(b)(5), did

---

[2] We think that, as the facts were significantly different, Helvering v. Cement Investors, 316 U.S. 527, did not over-rule Helvering v. Limestone Company, 315 U.S. 179.

[3] If United States v. Arcade Co., 203 F. (2d) 230 (C.A. 6), can be said to hold to the contrary, we refuse to follow it.

not go on to consider whether the transaction was tax-free under Section 112(b)(4) or some other "reorganization" subsection. Assuming that taxpayer has correctly described those cases, they cannot be considered as precedents here. See *Webster* v. *Fall,* 266 U.S. 507 511: "Questions which merely lurk in the record, neither brought to the attention of the Court nor ruled upon, are not be considered as having been so decided as to constitute precedents."[4]

(C) A further argument advanced by taxpayer runs thus: The Tax Court found that "the principal reason for the entire transaction was the exploitation of the scissors patents" acquired from natural persons by the new company; therefore, the transfer to the new company of its intangible assets, and the simultaneous transfer of the patents, both in exchange for common stock of the new company, must be regarded as one transaction; so regraded, it cannot come within Section 112(b)(4), which deals exclusively with intercorporate transactions.

We do not agree. There were two separate transfers which did not become transmuted into component steps of a single transfer merely because separate properties were transferred at the same time to one transferee These two transfers were not—as in the case of the transfer by the old company to its liquidating directors and the re-transfer by them to the new company—mere "procedural" steps towards the completion of one transaction. Nor were the two transfers, otherwise distinct, fused into one merely because the interested persons would not have entered into the arrangement unless it involved both

[4] Cf. Helvering v. Cement Investors, 316 U.S. 527, 530 note 1, where the Court said: "In Helvering v. Southwestern Consolidated Corporation [315 U.S. 194], no question as to the applicability of Sec. 112(b)(5) was involved. The only question raised or considered by . . . this Court was whether or not the transaction in question qualified as a 'reorganization' under Sec. 112(g)(1) of the 1934 Act."

transfers contemporaneously. None of the cases cited by the taxpayer leads us to the result that these transactions should escape the tax consequences which would have followed had they been separated in time.

We do not hold that the dominant aim of the interested persons may never be controlling in this area of "tax law." We do hold that, on the facts of this case, there occurred (1) a tax-free reorganization exchange of the old company's intangible assets for new company stock plus (2) a separate non-reorganization exchange of the patents for such stock. Therefore, the "basis" of the intangible assets is that of the old company.[5]

2. We think the Tax Court correctly excluded, from taxpayer's "equity invested capital," the market value of the shares of common stock issued to Ladd in exchange for services. For Section 718(a)(2) of 26 U.S.C., 1946 ed. is explicitly restricted to "property . . . previously paid in"; and services have been held not to constitute "property" for such purposes. *La Belle Iron Works* v. *United States*, 256 U.S. 377, 389; *Simmons Company* v. *Commissioner*, 33 F. (2d) 75 (C.A. 1). Taxpayer argues that Section 69 of the New York Stock Corporation Law provides for the issuance of stock for "labor done" as well as for money or property actually received. We think such a state statute irrelevant in interpreting the provisions of the Federal Revenue Act here applicable.

Affirmed.

---

[5] We need not and do not consider whether (a) the interests in the new company were disproportionate for purposes of Section 112(b)(5), or (b) whether the "basis"of the transferred patents is their cost as of the date of transfer in 1930.

Nor have we considered the Commissioner's contention that taxpayer is estopped from now asserting that the exchange in 1930 was not tax-free because taxpayer and its predecessor treated the transaction as a tax-free reorganization in the 1930 tax return.